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Liquid Alternatives: Investor and Fund Manager Outlook

April 2015









Liquid Alternatives - Introduction


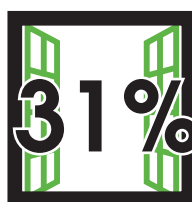


The rise of liquid alternative products, such as UCITS and alternative mutual funds, have opened up the possibility of hedge fund investment for more than just the largest investors. These regulated products, with lower investment minimums

and fees, have proved attractive to retail clients, and institutional investors and funds of hedge funds have shown an increasing interest in these products. In this section, we examine the current universe of hedge funds structured under

the UCITS and '40 act regimes, taking a closer look at the barriers to entry and the investors in these funds.


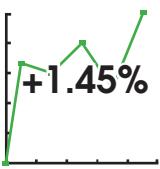


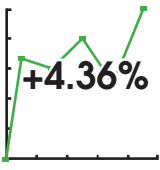
UCITS	Alternative Mutual Funds
 <p>798 Number of active UCITS funds.</p>	 <p>348 Number of alternative mutual funds.</p>
 <p>64 Number of new UCITS funds launched in 2014.</p>	 <p>53 Number of new alternative mutual funds launched in 2014.</p>
 <p>\$199bn Assets under management of UCITS funds (as of December 2014).</p>	 <p>\$240bn Assets under management of alternative mutual funds (as of December 2014).</p>

Source: Preqin Hedge Fund Analyst

Reasons Why Investors Use Liquid Alternatives			
 <p>51%</p> <p>Increased Liquidity*</p>	 <p>31%</p> <p>Increased Transparency*</p>	 <p>28%</p> <p>Regulated Nature of the Structure*</p>	 <p>19%</p> <p>Lower Costs Involved*</p>

*Proportion of current investors in liquid alternatives.

Source: Preqin Investor Interviews, November 2014

Average Minimum Investment Size of Alternative Mutual Funds	Performance in 2014
 <p>\$190,000 Alternative Mutual Funds</p>	 <p>+1.45% Return of UCITS funds over 2014.</p>
 <p>\$414,000 UCITS Funds</p>	
 <p>\$1.261mn Commingled Hedge Funds</p>	
	 <p>+4.36% Return of alternative mutual funds over 2014.</p>

Source: Preqin Hedge Fund Analyst

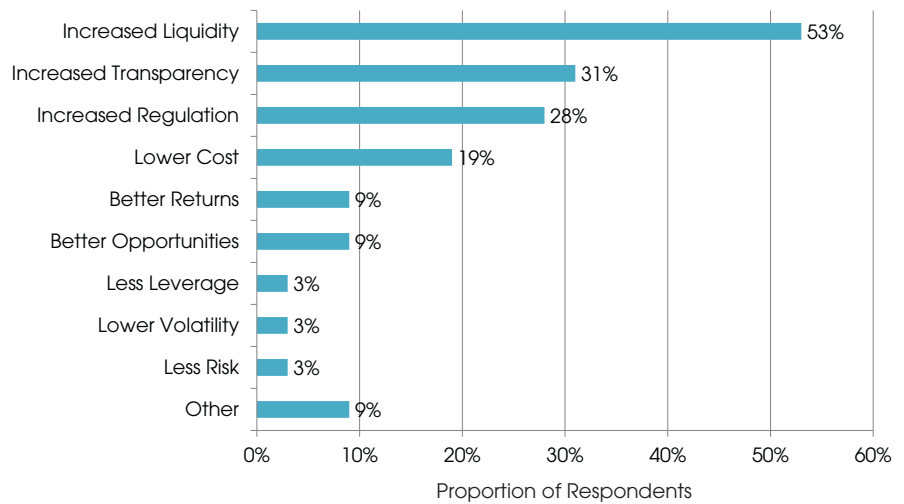
Overview of Liquid Alternative Funds

In recent years, there has been a proliferation of alternative routes into hedge funds, with new structures rising to prominence that offer investors greater liquidity and transparency with lower barriers to entry. In Europe, the UCITS structure has been a way for hedge funds to offer their hedge fund strategies to those investors looking to allocate to hedge funds through a more regulated and liquid product. Similarly, in the US, there has been significant growth in the number of hedge funds offered through a '40 act mutual fund structure. In this section, we take a look at the demand for liquid alternatives and why they are attractive to investors.

Why Do Investors Allocate to Liquid Alternatives?

Preqin surveyed institutional investors with a current allocation to an alternative mutual fund or UCITS product in order to gain insight into their attitudes towards investing in liquid alternatives (Fig. 1). The majority of those interviewed (53%) cited increased liquidity as the leading reason for investing in hedge funds through a liquid alternative structure. Looking at Fig. 2, we can see that both alternative mutual funds and UCITS funds grant their investors more frequent access to capital compared to traditional, commingled hedge funds, which makes them an attractive solution for investors that want frequent access to capital. Increased transparency (31%) and access to a regulated strategy (28%) are other leading reasons for investing in liquid alternatives.

Fig. 1: Investors' Reasons for Investing in Liquid Alternatives



Source: Preqin Investor Interviews, November 2014

Fig. 2: Mean Terms & Conditions for Liquid Alternative Funds vs. Hedge Funds

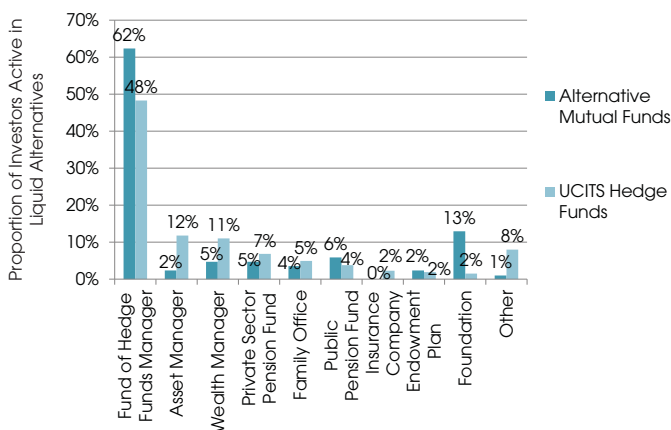
Terms & Conditions	UCITS Funds	Alternative Mutual	Hedge Funds
Minimum Investment (\$000s)	414	190	1,261
Management Fees	1.42%	1.04%	1.55%
Redemption Frequency (Days)	3	1	56

Source: Preqin Hedge Fund Analyst

Liquid alternative funds also have lower barriers to entry which make them accessible to a wide range of investors (Fig. 2). The minimum investment for alternative mutual funds is \$190,000; the average hedge fund, on the other hand, requires a minimum investment that is five times higher. UCITS funds

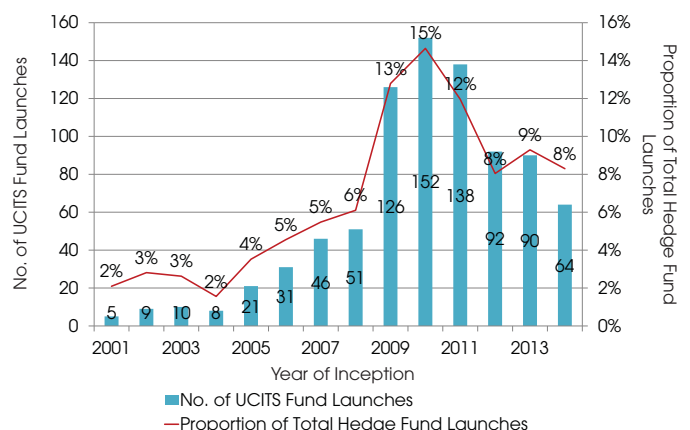
have an average minimum investment size of \$414,000. Nineteen percent of investors stated that they allocate to liquid alternatives as a lower-cost route into hedge fund investment (Fig. 1). Both UCITS and alternative mutual funds charge, on average, lower management fees than commingled hedge funds (Fig.

Fig. 3: Proportion of Investors Allocating to Liquid Alternative Hedge Funds



Source: Preqin Hedge Fund Investor Profiles

Fig. 4: UCITS Fund Launches Each Year as a Proportion of Total Hedge Fund Launches



Source: Preqin Hedge Fund Analyst

2). These traits have opened up the opportunity to invest in hedge funds to a wider audience of investors; in turn, those hedge fund managers that offer their strategies as liquid alternatives can grow assets across a broad spectrum of allocators.

Investors in Liquid Alternatives

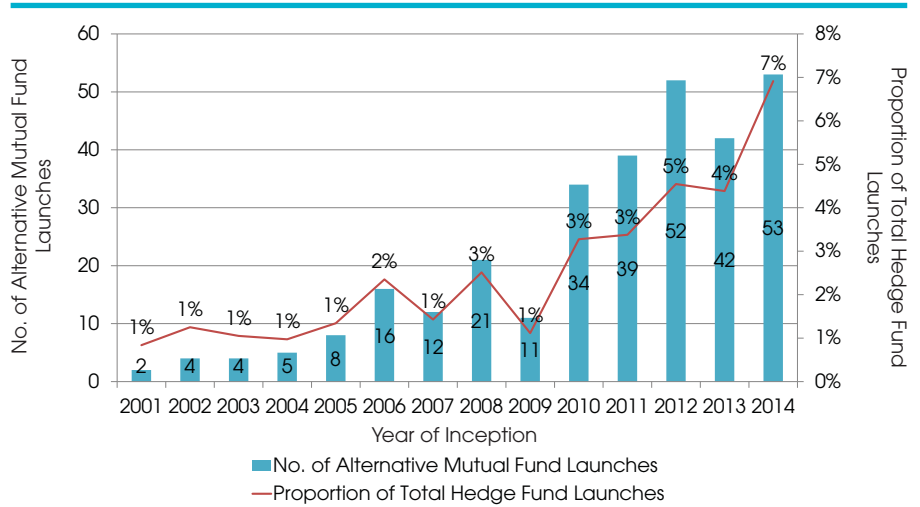
Fig. 3 shows that fund of hedge funds managers make up the largest proportion of investors with an allocation to alternative mutual funds (62%) and UCITS hedge funds (48%). Fund of hedge funds managers were among the earliest adopters of these products, and many have begun to use liquid alternatives as part of their wider hedge fund investments. Asset managers and wealth managers account for 12% and 11% respectively of investors allocating to UCITS funds; the liquid, transparent and familiar structure meets the needs of the clients these asset managers and wealth managers serve, and these groups play a significant role in channelling capital into liquid alternatives. In the US, foundations have a significant interest in alternative mutual funds: 13% of all alternative mutual fund investors tracked by Preqin are in this group.

Liquid Alternative Fund Launches

Alternative mutual funds have seen a rise in prominence over the past few years, as shown in Fig. 5. 2014 saw the highest number of alternative mutual fund launches on record; it is likely the final number of alternative mutual funds launched in 2014 will be even higher than this, as more data becomes available in the first half of 2015. This illustrates that fund managers are increasingly looking to diversify their product line-up to meet the demands of a growing audience of investors looking to gain access to hedge fund strategies. Undeniably, 2014 has witnessed the growth in significance of alternative mutual funds within the hedge fund industry, with the proportion of alternative mutual fund launches reaching the highest on record, at 7% of all hedge fund launches.

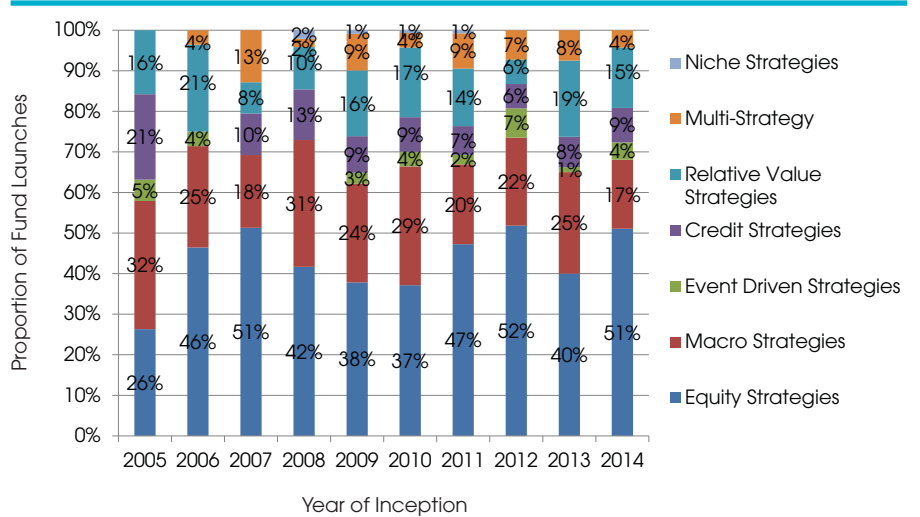
In contrast, there has been a decline in the number of UCITS-compliant hedge fund launches over the past few years (Fig. 4). Post-financial crisis, there was a surge in UCITS launches as fund managers responded to investor demands for liquid, regulated and transparent structures with new products that could meet these needs. This increase in the number of UCITS launches reached a peak in 2010, a year in which 152 new UCITS products came into market. In 2014, 64 hedge funds strategies offering a UCITS

Fig. 5: Alternative Mutual Fund Launches Each Year as a Proportion of Total Hedge Fund Launches



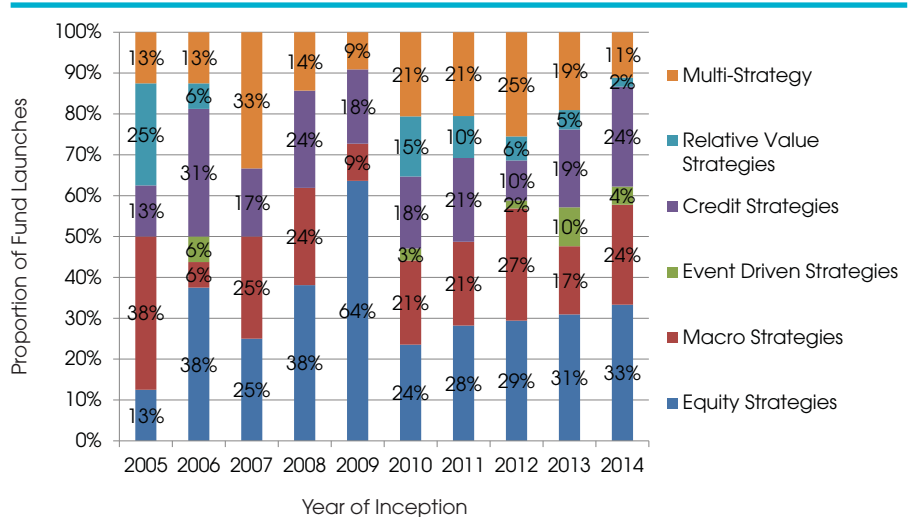
Source: Preqin Hedge Fund Analyst

Fig. 6: Strategy Breakdown of UCITS Fund Launches by Year of Inception



Source: Preqin Hedge Fund Analyst

Fig. 7: Strategy Breakdown of Alternative Mutual Fund Launches by Year of Inception



Source: Preqin Hedge Fund Analyst

structure were launched; however, this number is expected to increase to around the same level as seen in 2013 and 2012, 90 and 92 respectively, as more data becomes available.

It is unsurprising, given the liquidity restrictions imposed on the structures, that liquid strategies, such as equity strategies and macro strategies, are dominating both the alternative mutual fund and UCITS landscape (Fig. 7 and Fig. 6, respectively). However, despite offering daily liquidity, a greater proportion of alternative mutual funds offer credit strategies than is seen among UCITS funds; in 2014, nearly a quarter of all alternative '40 act fund launches had a credit focus, compared to just 9% of UCITS.

Performance of Liquid Alternatives

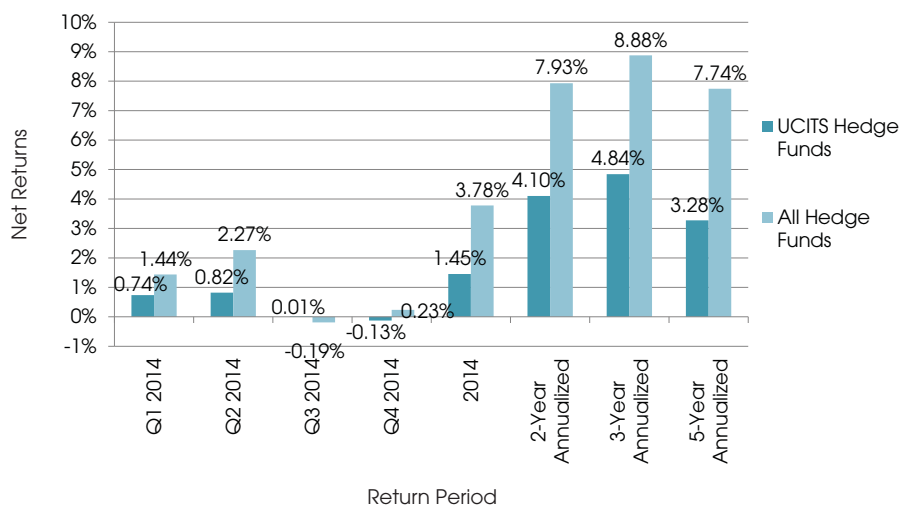
As regulated products, liquid alternatives are subject to restrictions on the instruments and leverage that fund managers can employ, which limits the implementation of the full hedge fund strategy. As a result, these products tend to produce lower returns, with lower volatility than their commingled hedge fund counterparts (Fig. 10)

In 2014, UCITS hedge funds were unable to avoid the difficulties affecting the broader hedge fund industry, posting 1.45% for the year. This was more than five percentage points down on the gains posted in 2013 (+6.82%). Q4 proved to be the worst quarter for UCITS funds, with a slight gain in November failing to offset the marginal declines seen in October and December (Fig. 8).

In the alternative mutual fund space, Q3 proved the most testing, with a loss in July followed by a decline in September, representing the worst month for alternative mutual funds in over a year. Despite the performance in 2014 failing to match the double-digit return generated in the same period last year, the Alternative Mutual Fund benchmark beat the Prequin All-Strategies Hedge Fund benchmark in 2014 (Fig. 9).

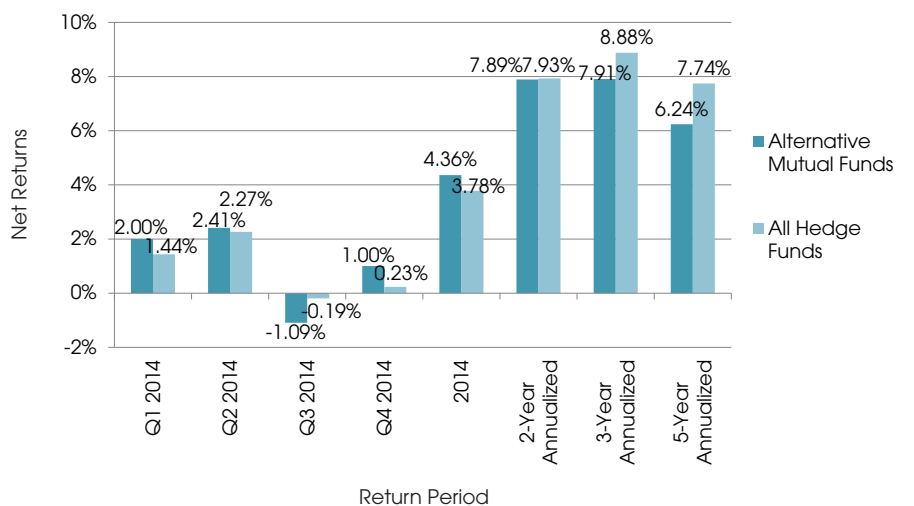
Despite the disappointing performance in 2014, UCITS-compliant hedge funds and alternative mutual funds continue to demonstrate their ability to consistently deliver absolute returns over the longer term. Annualized gains of 3-5% were posted by UCITS hedge funds over the two-, three- and five-year periods to the end of 2014. Although more volatile (Fig. 8), alternative mutual funds have delivered higher returns in the region of 6-8% over the same periods (Fig. 9).

Fig. 8: Performance of UCITS Hedge Funds (As at December 2014)*



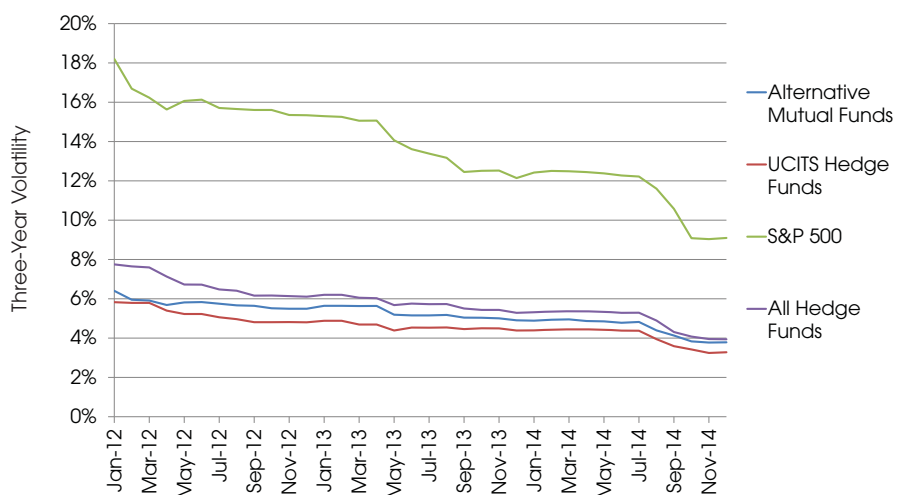
Source: Prequin Hedge Fund Analyst

Fig. 9: Performance of Alternative Mutual Funds (As at December 2014)*



Source: Prequin Hedge Fund Analyst

Fig. 10: Rolling Volatility of UCITS Hedge Funds, Alternative Mutual Funds, Hedge Funds and S&P 500 Benchmark, January 2012 - December 2014*



Source: Prequin Hedge Fund Analyst

*Please note, all performance information includes preliminary data for December 2014 based on net returns reported to Prequin in early January 2015. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.

Outlook

As more investors look to diversify their portfolios by investing in hedge fund strategies, there has been a proliferation of alternative structures to the offshore commingled product to allow these investors access to the asset class. The US mutual fund structure and European UCITS structure have allowed fund managers to replicate their strategies in a

transparent, liquid, regulated and familiar structure, which can appeal to both retail clients and, increasingly, institutional investors. Although the limitations on the strategy may impact the ability of liquid alternatives to deliver the same level of performance as hedge funds, the lower volatility and barriers to entry will continue to appeal to investors seeking alternative investments which can deliver consistent, risk-adjusted returns. For fund managers

looking to strengthen their product offerings and appeal to a broader group of investors, the growing interest in these products from a large range of investors may lead to inflows in 2015.

Fig. 11: 10 Largest Liquid Alternative Funds by Assets under Management

Fund	Manager	Structure	Assets under Management	Core Strategy
Standard Life Global Absolute Return Strategies Fund	Standard Life Investments	UCITS	\$35.4bn as at 30 September 2014	Multi-Strategy
J.P. Morgan Strategic Income Opportunities Fund	J.P. Morgan Asset Management	Alternative Mutual Fund	\$26.9bn as at 30 September 2014	Long/Short Credit
GS Strategic Income Fund	Goldman Sachs Asset Management	Alternative Mutual Fund	\$25.9bn as at 30 September 2014	Long/Short Credit
BlackRock Strategic Income Opportunities Fund	BlackRock Alternative Investors	Alternative Mutual Fund	\$20.5bn as at 30 September 2014	Long/Short Credit
MainStay Marketfield Fund	MainStay Investments	Alternative Mutual Fund	\$16.0bn as at 30 September 2014	Multi-Strategy
JPMIF Income Opportunity Fund	J.P. Morgan Asset Management	UCITS	\$9.5bn as at 30 September 2014	Fixed Income Arbitrage
Morgan Stanley Investment Funds - Diversified Alpha Plus	Morgan Stanley Investment Management	UCITS	\$8.6bn as at 30 September 2014	Macro
Gateway Fund	Natixis Global Asset Management	Alternative Mutual Fund	\$8.0bn as at 30 September 2014	Long/Short Equity
AQR Managed Futures Strategy Fund	AQR Capital Management	Alternative Mutual Fund	\$6.4bn as at 30 September 2014	Managed Futures/CTA
John Hancock Global Absolute Return Strategies Fund	John Hancock Investments	Alternative Mutual Fund	\$5.9bn as at 30 September 2014	Multi-Strategy

Source: Preqin Hedge Fund Analyst

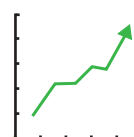
Key Facts



Proportion of investors in liquid alternatives that allocate capital as a result of the increased liquidity of these funds.



These funds have lower investment minimums and fees, which allow smaller investors and retail clients to access hedge fund strategies.



Alternative mutual funds have outperformed alternative UCITS on a one-, two-, three- and five-year annualized basis.

Data Source:

Preqin's **Hedge Fund Analyst** contains detailed profiles for over 1,400 UCITS and alternative mutual funds, including information on investment focus, fund strategies, geographic and industry preferences, and much more.

Preqin's **Hedge Fund Investor Profiles** provides access to comprehensive profiles for over 340 investors that are open to investing in liquid alternative funds. Profiles include information on current and target allocations to hedge funds, assets under management, strategy and geographic preferences and much more.

For more information, please visit:

www.preqin.com/hedge

Performance of UCITS and Alternative Mutual Funds

Fig. 12: Net Returns of Top Performing UCITS Hedge Funds in 2014

Fund	Manager	Core Strategy	Net Return in 2014 (%)
Montserrat Global Fund - B	Auriga Investors	Long/Short Equity	54.38
SEB Asset Selection Opportunistic Fund - C (H-NOK)	SEB Asset Management	Macro	34.83
Milltrust India Fund	Milltrust International	Long Bias	29.33
GAM Star Discretionary FX - GBP	GAM	Foreign Exchange	23.30
Sector Healthcare Value Fund - Class A NOK	Sector Asset Management	Long Bias	21.15

Source: Preqin Hedge Fund Analyst

Fig. 13: Net Returns of Top Performing Alternative Mutual Funds in 2014

Fund	Manager	Core Strategy	Net Return in 2014 (%)
Daman Fifth Fund	Daman Investments	Long Bias, Value-Oriented	231.95
Biotechnology UltraSector ProFund - Investor Class	ProFund Advisors	Long/Short Equity	45.20
Health Care UltraSector ProFund - Investor Class	ProFund Advisors	Long/Short Equity	36.83
BlackRock Real Estate Securities Fund - Investor A	BlackRock Alternative Investors	Long/Short Equity	31.18
Touchstone Global Real Estate Fund - Institutional Class	Touchstone Investments	Long/Short Equity	30.37

Source: Preqin Hedge Fund Analyst

Fig. 14: Net Returns of Top Performing UCITS Hedge Funds, January 2012 - December 2014

Fund	Manager	Core Strategy	Annualized Return, 2012-2014 (%)
Montserrat Global Fund - B	Auriga Investors	Long/Short Equity	39.72
Arcus Japan Fund - Relative Institutional Class	Arcus Investment	Long Bias	29.83
Sector Healthcare Value Fund - Class A NOK	Sector Asset Management	Long Bias	28.80
Tiburón Taiko Fund - Class A (JPY)	Tiburón Partners	Long Bias	22.96
Vitruvius Japanese Equity Portfolio - BI (JPY)	Belgrave Capital Management	Long Bias	22.91

Source: Preqin Hedge Fund Analyst

Fig. 15: Net Returns of Top Performing Alternative Mutual Funds, January 2012 - December 2014

Fund	Manager	Core Strategy	Annualized Return, 2012-2014 (%)
Biotechnology UltraSector ProFund - Investor Class	ProFund Advisors	Long/Short Equity	73.05
Daman Fifth Fund	Daman Investments	Long Bias, Value-Oriented	72.62
Health Care UltraSector ProFund - Investor Class	ProFund Advisors	Long/Short Equity	41.93
Consumer Services UltraSector ProFund - Investor Class	ProFund Advisors	Long/Short Equity	38.27
Merk Currency Enhanced U.S. Equity Fund - Institutional Class	Merk Investments	Foreign Exchange	21.58


Source: Preqin Hedge Fund Analyst

Access In-Depth Data on Top Performing Hedge Funds

Preqin's **Hedge Fund Analyst** features performance data for more than 11,200 hedge funds and share classes worldwide, offering a complete overview of the performance of the industry over time. Use **Hedge Fund Analyst** to:

- Access detailed profiles of each individual fund and its manager
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Liquid Alternatives: Investor and Fund Manager Outlook

April 2015

Preqin: Global Data and Intelligence

With global coverage and detailed information on all aspects of the hedge fund asset class, Preqin's industry-leading Hedge Fund Online services keep you up-to-date on all the latest developments across the hedge fund universe.

Source new investors for funds

Find the most relevant investors, with access to detailed profiles for institutional investors actively investing in hedge funds, including insurance companies, pension funds, family offices, foundations, wealth managers, endowment plans, banks and more.

Identify potential investment opportunities

View in-depth profiles for hedge funds seeking capital, including information on investment strategy, geographic focus, structure, service providers used, sample investors, direct contact information and more.

Find active fund managers in hedge funds

Search for firms operating hedge funds. View information on key contacts, assets under management, performance history, key investment preferences, known investors and more.

Benchmark performance

Identify which fund managers have the best track records with fully customizable performance benchmarks and view performance details on individual named funds and share classes.

Examine fund terms and conditions

Access fund-by-fund and industry level fund terms and conditions data for individual hedge funds, which provide a market overview, enabling you to see the current trends for specific strategies, structures, sizes, and more.

View detailed profiles of service providers

Search for active administrators, custodians, prime brokers, auditors and law firms by type and location of funds and managers serviced. Customize league tables of service providers by type, location of headquarters, and total known number of funds serviced.

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